

Message Text

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ACTION ARA-14

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AMCONSUL SAO PAULO

C O N F I D E N T I A L SECTION 1 OF 2 BRASILIA 1663

PASS TREASURY FOR BERGSTEN AND HUFBAUER

E.O. 11652: GDS
TAGS: ETRD, EFIN, BR
SUBJECT: TREASURY TEAM TALKS IN BRAZIL (1ST OF 3 MESSAGES):
SUMMARY AND TAX ISSUES

1. SUMMARY. TREASURY TEAM HEADED BY DEPUTY ASSISTANT SECRETARY HUFBAUER HELD TALKS AT MINISTRY OF FINANCE 28 FEB - 2 MAR ON TAX, TRADE, AND COUNTERVAILING DUTY MATTERS. FULL AND FRANK EXCHANGE OF INFORMATION AND VIEWS LED TO BETTER UNDERSTANDING OF STATUS OF SEVERAL ISSUES AND AGREEMENT ON NEXT STEPS. DISCUSSION OF REVOCATION OF U.S. TAX CREDIT ON GOB TAX ON INTEREST REMITTANCE TO U.S. (BANK OF BRAZIL RULING) CONCLUDED WITH UNDERSTANDING THAT TREASURY WILL ANNOUNCE REVOCATION IN NEAR FUTURE AFTER CONSIDERATION OF BOG PROPOSAL FOR GRANFATHER PERIOD AND AFTER PRIOR NOTIFICATION TO GOB. TREASURY AND MINISTRY OF FINANCE DELEGATIONS DISCUSSED REMAINING OBSTACLES TO NEGOTIATION OF BILATERAL TAX TREATY. TREASURY TEAM AGREED TO TAKE UNDER CONSIDERATION IN WASHINGTON GOB PROPOSAL TO PROCEED WITH NEGOTIATION OF A LIMITED
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TAX CONVENTION THAT WOULD OMIT REFERENCE TO PROBLEM AREAS. DETAILED DISCUSSIONS OF BRAZILIAN EXPORT SUBSIDIES INCLUDED U.S. EMPHASIS ON NEED FOR AGREEMENT ON MODIFICATION OF SUBSIDIES IN ORDER TO PRECLUDE APPLICATION OF U.S. COUNTERVAILING DUTIES. GOB EXPLAINED HIGH LEVEL DECISION TO WORK ACTIVELY FOR MULTILATERAL CODE ON EXPORT SUBSIDIES/COUNTERVAILING

DUTIES AND TO POSTPONE CONSIDERATION OF A BILATERAL AGREEMENT IN THIS AREA UNLESS AND UNTIL (PERHAPS WITHIN 4-6 MONTHS) AN MTN CODE IS DETERMINED TO BE NOT ACHIEVABLE OR ACCEPTABLE TO GOB. TREASURY TEAM EXPLAINED OUTSTANDING COUNTERVAILING DUTY PETITION ON TEXTILES AND GOB AGREED TO PROVIDE UPDATING INFORMATION ON BRAZILIAN EXPORT SUBSIDIES. U.S. SIDE AGREED TO CONSIDER GOB REQUEST THAT RECALCULATION OF COUNTERVAILING DUTY ON SHOES BE POSTPONED ON CONDITION THAT A MEMORANDUM OF UNDERSTANDING INSURES THAT THE RECALCULATION WILL TAKE PLACE BY NO LATER THAN END 1978 IF A MUTUALLY SATISFACTORY AGREEMENT ON SUBSIDIES IS NOT REACHED IN THE MTN BEFORE THAT DATE. GOB AGREED TO CONSIDER A U.S. REQUEST FOR APPROVAL OF U.S. CUSTOMS ENTRY TO CONDUCT SPECIFIC INVESTIGATIONS IN BRAZIL. TREASURY TEAM REVIEWED U.S. POSITION ON ON MTN FRAMEWORK ISSUES AND PLACED EMPHASIS ON IMPORT RESTRICTIONS TAKEN BY BRAZIL FOR BALANCE OF PAYMENTS REASONS. GOB SPOKESMEN REITERATED BRAZIL'S INSISTENCE ON SPECIAL AND DIFFERENTIAL TREATMENT AND ALSO MADE INQUIRIES REGARDING STEEL TRIGGER PRICE MECHANISM AND PENDING REQUEST FOR U.S. CERTIFICATION OF BRAZILIAN AIRCRAFT FOR SALE IN U.S. END SUMMARY.

2. TAX ISSUES. WITH RESPECT TO THE BANCO DO BRASIL RULING, TREASURY SPOKESMAN (HUFBAUER AND HORST) CONFIRMED THAT CONFIDENTIAL

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REVOCATION WAS IMMINENT, THAT EXISTING LOANS WOULD BE GRANFATERED FOR ONE YEAR, BUT THAT GOB VIEWS ON THE LATTER POINT WERE WELCOME. GOB REPS (MINISTRY OF FINANCE GENERAL COUNSEL DORNELLES AND CENTRAL BANK DIRECTOR BRACHER) ARGUED THAT BECAUSE REVENUE COST OF CURRENT RULING WAS CONSIDERABLY LESS THAN THAT OF SAUDI ARABIA AND LIBYA, A LONGER GRANDFATHER PERIOD WAS APPROPRIATE. GOB ALSO ARGUED THAT U.S. ESTIMATE OF REVENUE COST, \$120 MILLION PER YEAR, WAS TOO HIGH, THAT U.S. TREASURY SHOULD CONTINUE TO SHARE CONCERN OVER GOB'S INTERNATIONAL BORROWING NEEDS, AND THAT SPECIAL CONSIDERATION FOR BRASIL'S ECONOMIC DEVELOPMENT SHOULD BE ACCORDED. GOB REQUESTED THAT ALL LOANS CURRENTLY REGISTERED WITH THE CENTRAL BANK, PLUS ANY NEW LOANS REGISTERED WITHIN THE NEXT YEAR, BE GRANFATHERED FOR FIVE YEARS.

3. GOB DID NOT OFFER ANY COMPROMISE BETWEEN ONE YEAR AND FIVE GRANDFATHERING. TREASURY SUGGESTIONS THAT GRANDFATHERING SHOULD END WHEN A LOAN TO THE ULTIMATE BRAZILIAN BORROWER WAS RENEGOTIATED OR ROLLED OVER, OR THAT GRANDFATHER CREDIT SHOULD BE LIMITED

TO THAT ITEM OF INCOME ALONE, HAD ONLY LIMITED APPEARL
TO GOB. GOB HAS NO CURRENT PLANS TO CHANGE ITS
TAXATION OF INTEREST WHEN RULING REVOKED, BUT INDICATED
THAT ANY CHANGE WOULD PROBABLY APPLY TO EXISTING AS
WELL AS NEW LOANS. TREASURY DELEGATION BELIEVE THAT
EXCHANGE OF VIEWS WAS CONDUCIVE TO MAINTAINING GOOD
RELATIONS WITH GOB, BUT UNCOVERED FEW NEW ALTERNATIVES
TO PREVIOUSLY STATED POSITIONS. FORMAL GOB RESPONSE
ON TAX CREDIT REVOCATION ISSUE
FOLLOWS IN PARAGRAPH 6.

4. TREASURY TEAM AGREED THAT, IN KEEPING WITH TRADITIONAL
PRACTICE AND CONSISTENT WITH CLOSE U.S. -BRAZIL
CONSULTATIVE RELATIONSHIP ON FINANCIAL MATTERS,
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TREASURY WILL ADVISE GOB VIA THE TREASURY ATTACHE IN BRASILIA
OF THE TIMING AND TERMS OF THE TAX CREDIT REVOCATION
PRIOR TO ANY PUBLIC ANNOUNCEMENT IN WASHINGTON.

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ACTION ARA-14

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O R 032100Z MAR 78
FM AMEMBASSY BRASILIA
TO SECSTATE WASHDC IMMEDIATE 6370
INFO AMCONSUL RIO DE JANEIRO
AMCONSUL SAO PAULO

C O N F I D E N T I A L SECTION 2 OF 2 BRASILIA 1663

PASSTREASURY FOR BERGSTEN AND HUFBAUER

5. DISCUSSIONS OF PROSPECTS FOR BILATERAL TAX TREATY

REVEALED THAT THE FOUR MAJOR OBSTACLES SUMMARIZED
IN 11 JAN LETTER FROM INTERNATIONAL TAX
COUNSEL ROSENBLUM TO DORNELLES STILL REMAIN; NAMELY,
TAX SPARING, DEDUCTIBILITY OF ROYALTIES, EXCESS
REMITTANCE TAX, AND LEVEL OF TAX ON ROYALTIES.
TREASURY PROBE OF BRAZILIAN POSITION INDICATED
LITTLE WILLINGNESS ON PART OF GOB TO ALTER TRADITIONAL
STANCE. GOB DID PROPOSE A LIMITED QUOTE CONSECRATION
END QUOTE TREATY REESTRICTED TO THOSE ITEMS WHOLLY
OR LARGELY AGREED TO IN PRIOR NEGOTIATIONS. TAX
SPARING AND INVESTMENT CREDIT WOULD NOT APPEAR IN
THE CONSECRATION TREATY. THE TREATY WOULD, HOWEVER,
CONTAIN A RAPID TERMINATION ARTICLE IN THE EVENT THAT
U.S. LAW RELATING TO DEFERRAL OR BRAZILIAN LAW
RELATING TO EXCESS REMITTANCE TAX OR WITHHOLDING
TAXES ON ACTIVITIES NOT COVERED IN THE TREATY
WERE CHANGED. HUFBAUER PROMISED TO RELAY
SUGGESTION AND, IF U.S. TREASURY
IN ACCORD, TO PREPARE DRAFT TEXT FOR JUNE 1978 MEETING.
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6. QUOTE SUMMARY OF POSITION OF REPRESENTATIVES
OF BRAZIL PRESENTED DURING DISCUSSIONS WITH REPRESENTATIVES OF THE U.S. (BRASILIA, 26 27 FEBRUARY 1978):
(1) THE 25 PERCENT WITHHOLDING TAX ON INTEREST
PAID WITH RESPECT TO LOANS REGISTERED WITH THE CENTRAL
BANK OF BRAZIL ON THE DATE OF SUCH REVOCATION SHOULD
BE A CREDITABLE TAX, WITHOUT REDUCTION FOR THE AMOUNT
OF THE PECUNIARY BENEFIT AND FOR THE PERIOD SPECIFIED
IN SUCH REGISTRATION. (2) SUCH CREDITS SHALL ALSO
BE AVAILABLE WITH RESPECT TO INTEREST PAID ON LOANS
REGISTERED WITH THE CENTRAL BANK DURING FISCAL
YEARS OF THE PERSON CLAIMING THE CREDIT BEGINNING
ON OR BEFORE JANUARY 1, 1979, FOR THE PERIOD
SPECIFIED IN SUCH REGISTRATION. SUCH PROCEDURE IS
CONSISTENT WITH THE PRECEDENT ESTABLISHED IN
CONNECTION WITH THE RECENT REVOCATION OF FOREIGN TAX
CREDIT RULING WITH RESPECT TO THE LYBIAN AND SAUDI
ARABIAN TAXES. HOWEVER WE MUST TAKE INTO ACCOUNT THE
TRANSACTIONS REFLECTED IN THOSE RULINGS AS OPPOSED
TO THE LONG TERM COMMITMENT OF FUNDS TO BRAZIL REQUIRED
BY BRAZILIAN INTERNAL LAW. (3) ALTERNATIVELY, BRAZIL
SUGGESTS AS AN AID TO SIMPLICITY, ENFORCEMENT AND
CLARITY, AND IN ORDER TO FACILITATE AN ORDERLY
TRANSITION AND NOT DISRUPT FLOW OF FUNDS TO BRAZIL,
THAT, UPON REVOCATION OF THE RULINGS, ALL INTEREST
PAID OR ACCRUED DURING A PERIOD ENDING FIVE YEARS
THEREFROM, THE FOREIGN TAX CREDIT UNREDUCED BY THE
PECUNIARY BENEFIT SHALL BE ALLOWED. END QUOTE.

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